



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

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June 15, 2001

Facsimile:

JAMES E. SPEED
Executive Director

Dear Mr. :

Re: **Eminent Domain: Valuation Formula; Compatibility in Zoning and Utility**

This is in response to your letter and fax to Assistant Chief Counsel Larry Augusta on behalf of your client, a California limited partnership ("Taxpayer"), requesting our legal opinion concerning three (3) issues regarding Taxpayer's right to an exclusion from change in ownership under section 68 of the Revenue and Taxation Code. You have outlined the pertinent facts and a statement of the issues in your letter, together with the parties' respective positions on those issues. For the reasons set forth below, we conclude that the assessor is correct in his belief that he must make an independent estimate of market value, in order to determine the appropriate base year value of the replacement property; and that based on the facts submitted to us, the properties appear to be currently "comparable," that is, currently similar in "function," having similar government (zoning) restrictions, and currently similar in "utility," having similar uses.

Facts

The facts as set forth in your letter are as follows:

Having sued the City of San Diego ("City") for inverse condemnation of 58 acres of vacant land ("In Lieu Parcel") zoned A-1-10 (residential use), Taxpayer was awarded about \$3.4 million ("Award"), payable within five (5) years, in a Stipulated Judgment that became final on September 25, 1996. Pursuant to the judgment, Taxpayer deeded the In Lieu Parcel to the City in August 1996 and the City paid Taxpayer one-half ($\frac{1}{2}$) of the Award in cash in August 1999.

In 1997, Taxpayer again sued the City for inverse condemnation of other land of Taxpayer, including 47 acres zoned A-1-10 ("The Ranch"). Although Taxpayer would have preferred cash to settle its claims as to The Ranch, the City lacked cash and owned only one property of sufficient value to exchange for The Ranch. As a result, in a comprehensive 1998 Settlement Agreement ("1998 Agreement") involving other properties of Taxpayer as well as The Ranch,¹ the City

¹ Although a "global" settlement, the 1998 Agreement provided for the separate, independent dismissal and release of each part of Taxpayer's inverse condemnation actions involving The Ranch, "The Villas" (a proposed 47-lot

agreed to sell to, and exchange with Taxpayer, 31.4 acres (“Nobel Property”) zoned R-1-5 (residential use) in consideration for Taxpayer conveying The Ranch to the City and canceling the unpaid balance of the Award for the In Lieu Parcel. Based on their independent appraisals, the parties agreed that the unpaid balance of \$1.7 million would be applied to purchase 2 lots in the Nobel Property (3.8 acres), and that Taxpayer’s deed to The Ranch would be exchanged for the City’s deed to the remaining 13 lots (27.6 acres) in the Nobel Property.

Taxpayer’s acceptance of the settlement was conditioned on City approving a zoning change for the Nobel Property to SR (scientific research) in conformance with the Community Plan; which approval the City granted in September 1999. Taxpayer and the City exchanged deeds for The Ranch and the Nobel Property on December 23, 1999 (“Transfer Date”). As is common, the actual change to SR zoning was conditioned on approval and recordation of a final subdivision map, which conditions had not been satisfied as of the Transfer Date nor even as of the present. Since the Transfer Date, Taxpayer has entered a contract for sale of the Nobel Property to a third party commercial developer.

At all times, Taxpayer has held the replaced and replacement properties, which are vacant, as investments for resale to developers. Taxpayer is not, and has never been, a development entity because it lacks the funding and bonding capabilities needed to satisfy the conditions (including, the construction of infrastructure and offsite improvements) necessary to record a final subdivision map.

In subsequent telephone conversations, you clarified that the 2-lot, 3.8-acre portion of the Nobel Property is the only claimed replacement property for the original In Lieu Parcel. A timely claim was filed on September 7, 2000 for both the transfer of base year value from the 2-lot (3.8 acre) portion of the Nobel Property for the In Lieu Parcel, and the 13-lot (27.6 acre portion) of the Nobel Property for The Ranch.²

Issues and Analysis

residential subdivision to be approved by the City) and “The Villages” (undeveloped land Taxpayer sold to Southern California Edison for \$4.9 million in November 1998). Articles II and V of the 1998 Agreement specified the terms and conditions by which Taxpayer’s litigation with respect to each property could be settled independently from the other properties. Specifically, Article V.A provided that all causes of action pertaining to The Ranch would be dismissed upon close of escrow for the City’s exchange/sale of the Nobel Property for The Ranch and ½ of the In Lieu Parcel Award.

² Some concern initially arose as to whether this claim with respect to the In Lieu Parcel was timely filed “within four years of the date the property was acquired by eminent domain or purchase or the date the judgment of inverse condemnation becomes final”, as required by subdivision (b) of Section 68. As is noted above, Taxpayer deeded the In Lieu Parcel to the City in August 1996, more than four years before the September 7, 2000 claim. However, Property Tax Rule 462.500, which was adopted to clarify section 68, states, at subdivision (g)(2)(C), that the relevant beginning measuring date is “The date the judgment of inverse condemnation becomes final or the date the taxpayer vacates the replaced property, *whichever is later*, for property taken by inverse condemnation.” 18 Cal. Code of Regs. § 462.500(g)(2)(C) (emphasis added). According to the facts supplied, the judgment became final on September 25, 1996, within four years of September 7, 2000.

In reviewing the facts in light of section 68, the San Diego County Assessor questioned whether the replaced properties (The Ranch and the In Lieu Parcel) and the replacement property (Nobel Property) are comparable: i.e., of similar size, utility and function. The Taxpayer believes the properties to be comparable, but questions the assessor's determination to make current, independent value estimates. Pending a hearing by the San Diego County Assessment Appeals Board on the appeal filed by the Taxpayer, you have posed the following three issues, addressed with our responses in order below.

Issue 1: If a property is exchanged for another, should the Assessor reappraise and compare the replaced and replacement properties as of the Transfer Date to determine if the full cash value of the replacement property was no more than 120% of the "amount received" [see Section 68(b)] or the "award or purchase price paid for the replaced property"[see Rule 462.500(c)(2)] (collectively, "120% Test")?

Yes.

The exclusion from change in ownership in question with respect to these properties was first enacted as subdivision (d) of section 2 of article XIII A of the California Constitution in June of 1982.³ The Legislature implemented subdivision (d) by the enactment of section 68, which provides in relevant part:

For purposes of Section 2 of Article XIII A of the Constitution, the term "change in ownership" shall not include the acquisition of real property as a replacement for comparable property if the person acquiring the real property has been displaced from property in this state by eminent domain proceedings, by acquisition by a public entity, or by governmental action which has resulted in a judgment of inverse condemnation.

The adjusted base year value of the property acquired shall be the lower of the fair market value of the property acquired or the value, which is the sum of the following:

- (a) The adjusted base year value of the property from which the person was displaced.
- (b) The amount, if any, by which the full cash value of the property acquired exceeds 120 percent of the amount received by the person for the property from which the person was displaced.

³ That subdivision provides:

(d) For purposes of this section, the term "change in ownership" does not include the acquisition of real property as a replacement for comparable property if the person acquiring the real property has been displaced from the property replaced by eminent domain proceedings, by acquisition by a public entity, or governmental action that has resulted in a judgment of inverse condemnation. The real property acquired shall be deemed comparable to the property replaced if it is similar in size, utility, and function, or if it conforms to state regulations defined by the Legislature governing the relocation of persons displaced by governmental actions. The provisions of this subdivision shall be applied to any property acquired after March 1, 1975, but shall affect only those assessments of that property that occur after the provisions of this subdivision take effect.

* * *

The Legislature stated that it “finds and declares that it is the intent of the people in enacting subdivision (d) of Section 2 of Article XIII A of the California Constitution to permit taxpayers to use the base year value of the property from which the taxpayer was displaced as the base year value of the property acquired, *in cases where the full cash value of the property is no more than 20 percent greater than the value received by the taxpayer* for the property from which the taxpayer was displaced.” Stats. 1983, Ch. 662, §1 (emphasis added). Property Tax Rule 462.500(d) manifests such intent by establishing the procedure to be used by the assessor in determining the appropriate adjusted base year value of the comparable replacement property. Paragraphs (2) and (3) of subdivision (d) of Rule 462.500 specifically state:

(2) If the full cash value of the comparable replacement property *does not exceed* 120 percent of the award or purchase price of the property taken, then the adjusted base year value of the property taken shall become the replacement property’s base year value.

(3) If the full cash value of the replacement property *exceeds* 120 percent of the award or purchase price of the property taken, *then the amount of the full cash value over 120 percent of the award or purchase price shall be added to the adjusted base year value of the property taken.* The sum of these amounts shall become the replacement property’s base year value. (Emphasis added.)

Thus, when determining the new base year value of the replacement property, the assessor must compare the fair market value of that property with the sum of the formula described in Rule 462.500(d) above, and apply the lower of the two values.⁴ The formula, in turn, requires the assessor to compare the *full cash value* of the replacement property with, in essence, the consideration received from the replaced, or taken, property, and to make adjustments if that full cash value is greater than 120 percent of such consideration.

It is also important to note that unlike in other statutes authorizing the transfer of base year values, the 120% formula under section 68 is not a “test” which, if failed to be met, completely disqualifies the replacement property for transfer of base year value treatment.⁵ Rather, the 120% element in the context of eminent domain and inverse condemnation is a part of the formula for determining the adjusted base year value of the property acquired. Failure to meet the 120% element does not disqualify the entire replacement property from transfer of base year value treatment as set forth in subsection (d)(3) of Rule 462.500, above.

The Assessor believes that an independent market value estimate must be made because, among other reasons, the comprehensive 1998 Agreement involved other properties of Taxpayer in addition to those exchanged. The Assessor also asserts that the respective values of each property are questions of fact that must be answered by his office and/or the appeals board, in order to

⁴ We will assume from this point forward that the formula generates a new factored base year value which is lower than the replacement property’s fair market value. However, this assumption should be tested once a formula value has been determined.

⁵ Compare, for example, Revenue and Taxation Code section 69.5, subdivision (g)(5) (transfer of principal residence base year values by persons over age 55 or disabled).

determine the extent to which the valuation requirements of section 68 and Rule 462.500 are met. We agree.

In a property exchange situation, reappraisals must occur in order to compare both the replaced and replacement properties to determine if the full cash value of the replacement property is no more than 120% of the "amount received" from the replaced property. Specifically, subdivision (d)(5) of Rule 462.500 requires the following base year value determination in a property exchange situation:

If there is no award or purchase price paid by the acquiring entity (i.e., an exchange) for the property taken, then the full cash value of the acquired property and the full cash value of the replacement property shall be determined by the assessor of the county in which each property is located for the purpose of applying the other provisions of this subdivision. The procedure set forth in subdivision (d) (1) through (d) (4) shall then be applied to determine the replacement property's base year value.

Thus, if the full cash value of the replacement property does not exceed 120 percent of the "full cash value" for the replaced property in a property "*exchange*" situation, the factored base year value of the replacement property *is* the transferred factored base year value of the replaced property. If, on the other hand, the full cash value of the replacement property does exceed 120 percent of the "full cash value" for the replaced property, the factored base year value of the replacement property is the transferred factored base year value of the replaced property, *plus the amount of value of the replacement property over 120 percent of the value of the replaced property.*

However, in a situation involving an "award" or "purchase price", the proper comparison is the full cash value of the replacement property to *the amount received* for the replaced property, per subdivision (d)(1). The "exchange" provision in subdivision (d)(5) is clearly applicable to the sale/exchange of the 13-lot (27.6 acre portion) of the Nobel property for the Taxpayer's deed to the Ranch. The latter, in subdivision (d)(1) is the comparison applicable to the Taxpayer's "purchase" of the two-lot, 3.8- acre portion of the Nobel Property for the Taxpayer's In Lieu Parcel, as it involves a transfer of "cash" consideration for the replacement property.

In making the calculation under subdivision (d)(1), it is important to note that if the In Lieu Parcel existed as one parcel or appraisal unit, the total amount of the "award" from the City must be compared to the value of the 2-lot portion of the replacement Nobel Property. There is no provision of law that authorizes the comparison of only a portion of the "award (the unpaid \$1.7 million) for the In Lieu Parcel, versus the value of the replacement property, the 2-lot portion of the Nobel Property. Unless the In Lieu Parcel consisted of separate lots or appraisal units, some of which were specifically allocated to the unpaid balance of the Award, (or the In lieu Parcel had been put to separate multiple uses), we find no authority for the use of only a portion of the Award for the In Lieu Parcel for purposes of comparison with the 2-lot portion of the Nobel Property. (See annotations 220.0352, 220.0253, & 200.0380, enclosed.) We have long been of the opinion that there may only be one replacement property for a replaced property. (See Annotation 200.0353, enclosed.) We see nothing in the facts presented indicating the allocation of lots or appraisal units, or multiple uses of the In Lieu Parcel. As such, the appropriate comparison would

be the value of the 2-lot portion of the Nobel Property (assuming that *it* was a separate parcel or appraisal unit) to the entire value of the Award for the In Lieu Parcel. The base year value to be transferred or adjusted would be the entire factored base year value of the In Lieu Parcel.

Thus, the 120% Test applies both to the purchase of the 2 Nobel Lots (3.8 acres) and also to the exchange of The Ranch for the 13 Nobel Lots. (The fact that the Taxpayer received this property “in exchange” rather than an “amount” or “award or purchase price paid” does not cancel the statutory and regulatory requirements discussed above.) In both situations, if the fair market value of the portion of the Nobel Property purchased or exchanged as a replacement for the In Lieu Parcel or for The Ranch exceeds 120 percent of the amount received, the excess needs to be added to the factored base year value of the replaced property (the In Lieu Parcel or The Ranch) in calculating the new factored base year value of that portion of the Nobel Property. If not, the factored base year value of the replaced properties may become the factored base year value of the purchased or exchanged portion of the Nobel Property.⁶

Finally, we do not agree with Taxpayer’s position concerning the application of Rule 2 in this situation. Although the acquisition of the replacement property in exchange for the replaced property appears to be the result of sophisticated negotiations, the purchase price presumption set forth in Rule 2 is limited to a “transfer under prevailing market conditions between parties . . . seeking to maximize their gains and neither being in a position to take advantage of the exigencies of the other.” (Rule 2, subdivision (a).) Here, the transfer involved negotiations in order to settle litigation, and involved eminent domain proceedings, which, by nature place one party at a disadvantage and do not indicate an open market transaction. Moreover, as discussed at length above, there are specific rules applicable to the valuation of property being taken by governmental action. Where there is a more specific provision that governs, the more general rule does not apply. Here, therefore, the assessor must follow the prescribed formula in section 68 and Rule 462.500 for valuing property taken under eminent domain, which precludes all other valuation calculations.⁷

Issue 2: Were all the properties similar in “function” by having similar governmental restrictions, including zoning?

Yes, as of the date of the sale and acquisition; but no, as to future restrictions.

Consistent with section 2(d) of Article XIII A of the Constitution, Rule 462.500(c) provides that “Replacement property. Shall be deemed comparable to the replaced property if it is similar in size, utility, and function.” Subdivision (c)(1) states:

(1) Property is similar in function if the replacement property is subject to similar governmental restrictions, such as zoning.

⁶ See Footnote 4.

⁷ Moreover, even if the Assessor were to use his appraised value of The Ranch to meet the statutory “award” requirement, we do not agree that under the purchase price presumption of Rule 2, the fair market values of The Ranch and the 13 Nobel Lots in light of the parties’ bargained for exchange under the 1998 Settlement Agreement are equal.

We have previously written that the rule requires only that the properties must be subject to "similar government restrictions," not identical ones. In our view, whether zoning restrictions are "similar" is a question of fact for the assessor in each case. We have not before encountered however, the situation here, where the zoning of the replacement property was one designation immediately before and at the time of the sale, but the parties negotiate to change it to a different designation after the sale⁸. Thus, the parties put the zoning "in transition" from one, apparently comparable, set of governmental restrictions, to another set of considerably different restrictions, as part of the process of acquiring the replacement property.

In analyzing an unusual situation such as this, we have consistently advised that the underlying intent of Section 2(d) of Article XIII A, - to correct the inequity that occurs when a governmental agency forces a property owner to relocate and make way for a public project through eminent domain proceedings or inverse condemnation, -should be observed. The displaced property owner should not be faced with the double penalty of a tax increase after a government-caused relocation. Correcting such an inequity does not mean permitting the property owner to experience a "gain," since this provision was not intended to be a tax *benefit*. However, the displaced property owner is allowed to replace what was lost through eminent domain proceedings, including replacement of the base year value, providing the replacement property is similar.

Here, there does not appear to be any disagreement that immediately before sale and exchange, the replacement properties (Nobel Property) and the replaced properties (In Lieu Parcel and The Ranch) had similar effective governmental restrictions, that is single-family residential zoning. The replaced properties (In Lieu Parcel and The Ranch) were zoned A-1-10 and A-1-15, and designated Open Space on the General/Community Plan. The replacement properties (Nobel Property) was zoned R-1 and designated "Scientific Research" or "Industrial" on the General/Community Plan. At the time of transfer and close of escrow however, negotiations had resulted in an agreement that the replacement properties (Nobel Property) would be rezoned "Scientific Research" and put to office and manufacturing use. The evidence suggests that this future zoning change was a condition demanded by the Taxpayer (under the 1998 Agreement), in order to match the investment potential of the replacement property with that of the replaced property. Since the Taxpayer is in the investment, rather than the development business, it intended to sell the replacement property to a developer, just as it had intended to sell the replaced property to a developer prior to the inverse condemnation. In our view, although the future zoning restrictions on the replacement property will change the replaced and replacement properties had similar zoning restrictions at the time of the sale and exchange, making them "comparable" in this regard. Although we have limited information and this is ultimately a question of fact for determination by the assessor and/or the assessment appeals board, the purposes of the constitutional provision and statute appear to be served by permitting the transfer of the Taxpayer's base year values from its replaced properties to the replacement property, assuming other criteria, including value considerations discussed above, are met.

Issue 3: Were all the properties similar in "utility" by having similar uses, both actual and intended?

⁸ See annotation No. 200.0360, enclosed, however, for a different situation in which the use of the property was limited although the General Plan designation was expanded.

Yes, as of the date of the sale and acquisition; but no, as to likely future uses.

With respect to similarity in “utility, Rule 462.500(c)(2) states that:

Both the size and utility of property are interrelated and associated with value. Property is similar in size and utility only to the extent that the replacement property is, or is intended to be, used in the same manner as the property taken (i.e., single-family residential and duplex, multi-family residential other than duplexes, commercial, industrial, agricultural, vacant, etc.) and . . .

As you and the Assessor both note, Rule 462.500(c) specifies that these comparability tests are interrelated with value in use, and that property “is similar in size and utility only to the extent that the replacement property is, or is intended to be, used in the same manner as the property taken . . .” Thus, the similarity of the size and utility of the properties, for purposes of this transfer of base year value treatment, is measured by comparing the *actual* use of the property taken, with the *actual or intended* use of the replacement property, and their values, as set forth in section 68 and Rule 462.500(c). This “use” test is further reinforced by the provisions of paragraph (2) (A) of Rule 462.500(c): “A replacement property or any portion thereof used or intended to be used for a purpose substantially different than the use made of the replaced property shall, to the extent of the dissimilar use be considered not similar in utility.”

Again, this is a factual determination to be made by the assessor (or assessment appeals board) on a case-by-case basis. However, given the purposes of section 2(d), section 68, and Rule 462.500, the actual and intended use of the replaced properties by the Taxpayer displaced by governmental action here – as vacant land being held for investment purposes for future sale to a developer – is similar to that of the replacement property. As to the present use, Taxpayer was holding the original properties (In Lieu Parcel and The Ranch) as “vacant land” for investment and for eventual resale to a developer. Its actual use was “vacant land” being held for future sale. The Taxpayer is apparently doing the same with the replacement property (Nobel Parcel), in that its actual use is vacant land being held for future sale to a developer. We note that “*vacant*” is one of the examples of “use” identified in subdivision (c)(2) of Rule 462.500. Therefore, if the value in use as vacant land is similar with respect to both the replaced and the replacement properties, we would conclude that Taxpayer’s use of the replacement property appears to meet the “utility” test defined in Rule 462.500. To the extent that the taxpayer is putting, or is likely to put, the replacement property to the same use as the replaced property was put (i.e., holding for investment and sale), it is our view that, assuming the other criteria are met, the “size and utility” test would be met.

The views expressed in this letter are advisory only; they represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity.

Sincerely,

/s/ Daniel G. Nauman

June 15, 2001

Daniel G. Nauman
Senior Tax Counsel

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Enclosures

cc: Hon. Gregory J. Smith,
San Diego County Assessor

Mr. Dick Johnson – MIC:63
Mr. David Gau – MIC:64
Mr. Charlie Knudsen, MIC:62
Ms. Jennifer Willis – MIC:70
Ms. Kristine Cazadd – MIC:82